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In the Supreme Court of the United States

OCTOBER TERM, 1975

UNITED STATES OF AMERICA AND INTERSTATE COMMERCE COMMISSION, APPELLANTS

v.

THE CHESAPEAKE AND OHIO RAILWAY COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA

BRIEF FOR THE APPELLANTS

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BRIEF FOR THE APPELLANTS

OPINIONS BELOW

The opinion of the district court (J.S. App. 1a–22a) is reported at 392 F. Supp. 358. The orders of the Interstate Commerce Commission in *Ex Parte No. 305, Nationwide Increase of Ten Percent in Freight Rates and Charges, 1974* (J.S. App. 27a–111a) are unreported.

JURISDICTION

The judgment of the district court (J.S. App. 23a–24a) was entered on April 22, 1975. The notice of appeal was filed on June 20, 1975 (J.S. App. 25a–26a). By

order of August 12, 1975, the Chief Justice extended the time for docketing the appeal to and including September 18, 1975. The appeal was docketed on September 16, 1975, and probable jurisdiction was noted on November 3, 1975. The jurisdiction of this Court rests on 28 U.S.C. 1253 and 2101(b). *Aberdeen & Rockfish R.R.* v. *SCRAP*, 422 U.S. 289.[1]

QUESTION PRESENTED

In April 1974 the Nation's railroads sought a general rate increase of 10 percent, representing to the Commission that at least part of the increase was needed to provide funds for maintenance and capital improvements that had been delayed. The Commission found that the increase appeared to be unjust and unreasonable unless the railroads devoted the bulk of the new revenues to these purposes. The railroads then filed new tariffs, which are subject to Commission orders ensuring that the increased revenues will be put to the proposed use.

The question presented is whether the Commission has the power to issue such orders, as a condition of not suspending proposed rate increases.

[1] Pub. L. 93–584, 88 Stat. 1917, provides that after February 28, 1975, review of Interstate Commerce Commission orders is in the courts of appeals, with review in this Court by certiorari. The complaint in the instant case was filed on August 15, 1974, and the old procedure, which required such complaints to be heard by a three-judge district court with review in this court by direct appeal, therefore governs.

STATUTES INVOLVED

The National Transportation Policy, 54 Stat. 899, 49 U.S.C. preceding Section 1, provides in relevant part:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation * * *; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; * * *—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of [the Interstate Commerce Act] * * * shall be administered and enforced with a view to carrying out the above declaration of policy.

Section 15(7) of the Interstate Commerce Act, 24 Stat. 384, as amended, 49 U.S.C. 15(7), provides:

> Whenever there shall be filed with the Commission any schedule stating a new individual or joint rate, fare, or charge, or any new individual or joint classification, or any new individual or joint regulation or practice affecting any rate, fare, or charge, the Commission shall have, and it is given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable

notice, to enter upon a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation, or practice; and pending such hearing and the decision thereon the Commission, upon filing with such schedule and delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may from time to time suspend the operation of such schedule and defer the use of such rate, fare, charge, classification, regulation, or practice, but not for a longer period than seven months beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after the rate, fare, charge, classification, regulation, or practice goes into effect, the Commission may make such order with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made within the period of suspension, the proposed change of rate, fare, charge, classification, regulation, or practice shall go into effect at the end of such period; but in case of a proposed increased rate or charge for or in respect to the transportation of property, the Commission may by order require the interested carrier or carriers to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a change in a rate, fare, charge, or classification, or in a rule, regulation, or practice, after the date this amendatory provision takes effect, the burden of proof shall be upon the carrier to show that the proposed changed rate, fare, charge, classification, rule, regulation, or practice is just and reasonable, and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible.

Section 15a(2) of the Interstate Commerce Act, as added by 41 Stat. 488, and amended, 49 U.S.C. 15a(2), provides:

> In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management to provide such service.

STATEMENT

A. BACKGROUND

Under the Interstate Commerce Act rates are set by the railroads, subject to disapproval by the Commission. A carrier may file a proposed rate increase

and after 30 days (or such shorter time as the Commission may authorize) the new rate becomes effective as a carrier-made rate. 49 U.S.C. 6(3). The Commission may suspend the proposed tariff for a maximum of seven months, while it conducts an investigation into the lawfulness of the rate. 49 U.S.C. 15(7). At the end of the suspension period the carrier may put the new tariff into effect unless the Commission, prior to that time, has completed its investigation and ruled that the proposed rate is unlawful. See *Arrow Transportation Co.* v. *Southern Ry.*, 372 U.S. 658.

These procedures govern both the carriers' collective requests for general revenue increases and individual rate filings. In general revenue proceedings, such as *Ex Parte 305*, involved here, the carriers as a group seek to increase the average rates charged. The average increase is an aggregate of the increases for particular commodities or specific groups of commodities; however, no specific authority is sought for any one of the particular increases.

If the carriers seeking a general revenue increase demonstrate that the increase is necessary to enable them to provide the Nation with adequate transportation and the Commission determines that it is consistent with the public interest, the Commission will authorize a general revenue increase.[2] The railroads then are free to increase their rates within the bounds

[2] See, *e.g.*, *Aberdeen & Rockfish R. R.* v. *SCRAP*, 422 U.S. 289, 311–319; *United States* v. *Louisiana*, 290 U.S. 70, 76–78. Cf. *Atchison, Topeka & Sante Fe Ry.* v. *Wichita Board of Trade*, 412 U.S. 800, 814, n. 10.

set by competition with each other and with alternative modes of transportation, so long as the revenue generated by the increases does not exceed the maximum the Commission has authorized.

B. PROCEEDINGS BEFORE THE COMMISSION

On April 22, 1974, the Nation's railroads (including appellees, the Chessie system) [3] filed a joint petition seeking permission to file tariffs embracing a 10 percent increase in the level of their freight rates to become effective on May 2, 1974 (App. 95–130).[4] The petition stated that "massive additional expenditures are required for maintenance and capital investments" (App. 107); supporting documents submitted by an industry association of which Chessie is a member estimated that these expenditures would exceed several billions of dollars annually.[5] See J.S. App. 30a, 33a–34a.

[3] The Chessie system ("Chessie") includes the Chesapeake and Ohio Railway Company, the Baltimore and Ohio Railway Company, and the Western Maryland Railway Company.

[4] The Long Island Rail Road did not join this request. J.S. App. 41a, n. 1. This request, as is common in general revenue proceedings, was made by the railroads after using the conference machinery authorized by 49 U.S.C. 5b.

[5] The petition was joined by Chessie in all particulars, including the petition's assertion that the funds were needed to make repairs and capital improvements. Representatives of the rail industry and industry associations submitted numerous affidavits and documentation dealing with the problems of specific railroads and the industry in general (see, *e.g.*, App. 131–209). Chessie did not disassociate itself from these presentations. Among the supporting documents were pertinent portions of the "ASTRO

Numerous protests were filed in opposition to the proposed increase, and on April 30, 1974, the Commission issued an order denying the carriers' petition insofar as it sought to put the increase in effect on May 2, 1974 (J.S. App. 27a–31a). However, by order of May 3, 1974 (J.S. App. 32a–40a), the Commission authorized the railroads to file tariffs implementing the increase on 30 days' notice. The Commission also authorized the filing of further statements opposing the increase and a reply statement by the railroads.

The bulk of the statements in opposition then filed by shippers, associations of shippers, and by others, simply asserted that the increase was unjustified in whole or in part. But a number of statements, reflecting the acute concern of the Nation's shippers about the deterioration of railroad bed and facilities, asserted that the increase *was* justified, but only upon terms ensuring that the revenues would be spent in ways calculated to improve rail service. For example, the National Industrial Traffic League stated: "the Commission should provide for protection of the shipping public by imposing an obligation upon the railroads to carry out their undertakings with respect to

Report", a publication entitled "The American Railroad Industry: A Prospectus," a report by America's Sound Transportation Review Organization, June 30, 1970, compiled for the Association of American Railroads (App. 175–180). This report estimated that the Nation's railroads will require expenditures exceeding $3 billion per year through 1980 for maintenance and capital improvements. An update of this report (the "ASTRO II Report") has increased this estimate to $3.81 billion per year, and also was submitted to the Commission (App. 136–137, 156–164).

right-of-way improvements and service improvements" (App. 213).[6]

In reply to the shippers' statements the railroads, while disavowing any need for express conditions, reaffirmed their earlier statements that a principal justification for the increase was their need to obtain additional revenues necessary to carry out maintenance and improve deteriorating plant and equipment.

On June 3, 1974, the Commission entered the first of the four orders attacked in the court below (J.S. App. 41a–54a). The Commission stated that it "is convinced that the service provided by the nation's railroads is less than adequate and is in danger of further deterioration detrimental to the public interest, that in order to improve service the railroads must generate additional revenues, and that the increases proposed would, if permitted to become effective, generate additional revenues sufficient to enable the carriers to prevent further deterioration and improve service" (J.S. App. 42a–43a). But, the Commission went on, "if the schedules were permitted to become effective as filed and without conditions designed to promote service improvements, the increases proposed would be unjust and unreasonable and contrary to the dictates of the national transportation policy" (J.S. App. 43a). Accordingly, the Commission suspended the tariffs embracing the increase but authorized the railroads to file new tariffs subject to conditions pro-

[6] Also see the statements of General Mills, Inc. (App. 217–221) and the Pillsbury Company (App. 214–216) to similar effect.

viding that most of the increase must be spent on deferred maintenance and delayed capital improvements.[7] This order was served on June 4, and the next day all the Nation's railroads, including Chessie, filed new tariffs pursuant to the terms and conditions of the June 3 order. The Commission did not suspend them and they became effective.[8]

On July 18, 1974, the Commission entered the second order at issue (J.S. App. 55a–76a). This order clarified the June 3 order by defining the terms "deferred maintenance" and "delayed capital improvements."[9] The Commission also established accounting and reporting requirements in order to verify compliance with the June 3 order (J.S. App. 64a–76a). The July 18 order provided that an increase of as much as three percent was authorized to be applied to increased material and supply costs (other than fuel), but that the balance of any revenues derived from the increase would have to be applied to deferred maintenance and delayed capital improvements (J.S. App. 64a). However, any income taxes incurred as a result of the increase could be subtracted in determining that balance, and, of course, since the increase was permissive in nature, the railroads were not required to take the full amount.[10]

[7] The conditions are reprinted in J.S. App. 45a–49a.

[8] By order of June 6, 1975, the Commission extended until April 30, 1976, the effectiveness of these interim increases. See J.S App. 106a–111a.

[9] These definitions appear at J.S. App. 56a–57a.

[10] Subsequent reports to the Commission indicated that the Chessie and nearly all other carriers implemented an effective rate of increase between eight and nine percent.

On July 30, 1974, Chessie requested the Commission to amend its orders to provide that a railroad without "deferred maintenance" or "delayed capital improvements," as defined, could expend for any valid corporate purpose the funds generated by the increase (App. 222–226). Chessie expressed concern that it had no "deferred maintenance" or "delayed capital improvements" and that it therefore would be unable to make use of the increase.[11] In addition, Chessie's petition raised for the first time the argument that the Commission is without power to impose such conditions (App. 226). The Nation's other railroads also filed a joint petition for reconsideration and clarification but did not challenge the Commission's power to impose conditions.

The Commission's order of August 9, 1974 (J.S. App. 77a–84a), while denying all petitions for reconsideration, further clarified the Commission's decisions by providing that carrier management would retain discretion to decide what projects meet the definitions of deferred maintenance and delayed capital improvements (*id.* at 81a) and by providing that railroads need not obtain Commission approval for particular projects. The Commission also recognized that some railroads, in anticipation of the increase, already had initiated improvement projects. In order to take account of this, the Commission allowed each railroad

[11] Chessie argued that on May 13, 1974, its boards of directors had approved a $124 million capital improvement program (App. 223). Under the Commission's orders, only capital improvements authorized after June 1, 1974, could be paid for with funds from the rate increase. See J.S. App. 56a.

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to count, as delayed capital improvements, projects to which funds initially were committed after January 1, 1974 (*id.* at 83a).[12] This plan was designed to allow railroads to use old revenues for ordinary expenditures or projects already planned, while diverting the new revenues to supplemental improvements.

Chessie brought this suit on August 15, 1974, seeking to set aside the Commission's orders of June 3, July 18 and August 9 (App. 4–14). No other railroad joined in the suit. On August 18 District Judge Merhige issued a temporary restraining order prohibiting the Commission from enforcing its orders against Chessie (App. 30–33).

On August 16, 1974, most of the Nation's railroads, but not Chessie, filed with the Commission another petition for clarification and modification of the July 18 and August 9 orders (App. 227–232). On August 22 the Commission reopened the matter (J.S. App. 85a–92a). It held oral argument on August 27, at which, by order of the Commission (J.S. App. 91a–94a), counsel for Chessie and the other railroads appeared.[13]

On October 3, 1974, the Commission entered an order substantially modifying the conditions estab-

[12] As a result, Chessie's $124 million program (note 11, *supra*) fell within the definition of delayed capital improvements.

[13] Chessie resisted appearing at this argument, contending that the filing of its complaint in court deprived the Commission of farther jurisdiction over it (App. 236–237). Relying upon *American Farm Lines* v. *Black Ball Freight Service*, 397 U.S. 532, 541–542, the Commission rejected that claim (J.S. App. 93a–94a). Chessie sent a representative to the argument.

lished by the prior orders (J.S. App. 98a–105a). The October 3 order provided (*id.* at 104a):

> * * * That railroad respondents, if any, which are unable to use the full amount of the funds generated by the increase for deferred maintenance or delayed capital improvements, as defined in this proceeding, may expend such funds for new and additional capital improvements providing advance approval is obtained from the Commission * * *.

Chessie amended its complaint (App. 34–44) to challenge the October 3 order as well. It claimed that the new order would not help it because its maintenance and capital projects could not qualify as "new and additional capital improvements" (App. 37–38). Chessie never sought the Commission's opinion on this matter, however, and never sought permission to proceed under the October 3 option.[14]

C. THE DECISION OF THE DISTRICT COURT

In October 1974 the United States and the Commission filed their answer to the amended complaint (App. 45–53). The answer contended that the Commission's orders were unreviewable suspension orders, that Chessie had failed to exhaust its administrative remedies, that Chessie was estopped from attacking the conditions because it was enjoying the benefits of the increase, and that the Commission's orders were lawful. Appellants simultaneously filed a motion to

[14] Seventeen railroads have been granted authority under the October 3 order; six have been denied such authority (J.S. App. 107a–108a).

dissolve the temporary restraining order issued in August 1974 (App. 54–55) and an affidavit of a Commission auditor indicating that Chessie's claim that it had no deferred maintenance was without factual support (App. 65–75).

The district court's judgment, entered on April 22, 1975, enjoined the Commission from enforcing against Chessie those portions of the challenged orders that required revenues derived from *Ex Parte 305* to be spent for specified purposes (J.S. App. 23a–24a).

The court's opinion rejected the preliminary defenses raised in the answer (J.S. App. 7a–16a). The court also rejected Chessie's contention that it should not have been required to keep records concerning how it spends the increased revenues it collects; the court held that the accounting and reporting requirements are unreviewable incidents of the Commission's suspension power (*id.* at 11a). Chessie has not appealed that portion of the court's judgment, and we do not seek review of the district court's disposition of the preliminary issues.

As to the merits, the district court recognized that the Commission's orders "are a well-intentioned effort to cope with the vexatious deterioration of track and equipment that saps the ability of the nation's railroads to serve the public adequately" (J.S. App. 22a), and that Chessie's facilities, like those of virtually all the Nation's railroads, "require additional maintenance and improvement" (*id.* at 15a). It concluded, however, that the conditions imposed by the Commis-

sion on the expenditures of the increased revenues are unlawful.

The court began with a recognition that "the Commission can impose conditions that have been expressly or impliedly authorized by law" (J.S. App. 16a). Because no provision of the Interstate Commerce Act expressly grants to the Commission the power to condition a revenue increase upon a particular use of the funds so generated, the court then inquired whether the Commission had been granted that power implicitly. It turned to Section 15a(2), upon which the Commission had relied, as a possible source of such implicit power.

The court held that Section 15a(2) does not create the necessary implicit power. It asserted that "[n]ever before has the Commission claimed that this section expands its rate-making power to embrace control over the expenditure of a carrier's revenue" (J.S. App. 18a), and observed that no other court had considered the precise issue before it. It drew an analogy to several cases in which courts had indicated that the Commission lacks the power to direct railroads to invest their capital in particular ways, stating that "courts have uniformly held that the Commission lacks statutory authority to order railroads how to spend their funds" (*id.* at 19a). Although recognizing that none of those cases dealt with the suspension of rates, the court held that "they unmistakenly establish that the Commission has no general power to control a

railroad's expenditures" (*id.* at 21a). Since, in the court's view, the requirements laid down by the Commission as conditions of nonsuspension of the proposed increases are an indirect attempt to accomplish an objective that could not be accomplished directly, it held that the conditions are invalid.

INTRODUCTION AND SUMMARY OF ARGUMENT

It is now widely understood that there is a crisis facing the Nation's railroads—a crisis characterized by a chronic inability to generate revenues sufficient to maintain a quality of service that would make railroads an attractive mode of transportation. The deterioration of the quality of service has been followed by further loss of patronage and further insufficiency of revenue. In short, a vicious circle has been established.[15] Most of the railroads in the northeastern United States are bankrupt, and a major midwestern carrier recently has become bankrupt.[16] This crisis caused Congress to reorganize the northeastern rail system under the Regional Rail Reorganization Act of 1973, 87 Stat. 985, 45 U.S.C. (Supp. III) 701 *et seq.* See generally *Regional Rail Reorganization Act Cases,* 419 U.S. 102.

The railroads—including Chessie—that requested the Commission to allow them to increase their rates

[15] See generally Altman, *Predicting Railroad Bankruptcies in America,* 4 Bell J. Econ. & Mgt. Sci. 184 (1973).

[16] The Chicago, Rock Island & Pacific Railroad filed for bankruptcy on March 17, 1975. *In re Chicago, Rock Island & Pacific R.R.*, No. 75B–2697, N.D. Ill.

argued strenuously that a rate increase was necessary to enable them to repair and improve their facilities. The Association of American Railroads, of which Chessie is a member, furnished to the Commission the "ASTRO Report," a comprehensive document indicating that the railroads need massive sums of money for maintenance and capital improvement.[17] The maintenance deficiencies noted by the Commission here (J.S. App. 47a–48a) also have been noted by Congress. S. 2718, 94th Cong., 1st Sess. (1975), the "Railroad Revitalization and Regulatory Reform Act of 1975," has been passed by both Houses of Congress and is awaiting transmission to the President. If signed by the President, it would provide approximately seven billion dollars of public money for the railroads' use.[18] Other laws already enacted are ad-

[17] See note 5, *supra.*

[18] See S. Rep. No. 94—499, 94th Cong., 1st Sess. 21–23 (1975). The estimates projected by various groups were described as follows: "The United States Railway Association projected, in the Final System Plan, that between 1976 and 1985 ConRail must invest over $6 billion in rehabilitation and improvement programs. Over $4 billion of this sum will be for improvements to fixed plant (one-third in rehabilitation monies and two-thirds for other improvements). Almost $2 billion will be spent for the acquisition of rolling stock and other equipment.

* * * * *

"The First National City Bank, with the aid of statistical data made available by the Department of Transportation and the Association of American Railroads, has projected that over the same 10 years, 1976 through 1985, the Nation's railroads, excluding ConRail, will need to invest in rehabilitation and improvement programs just short of $34 billion. Of that aggregate sum, almost $19 billion is foreseen as necessary for improvements to fixed plant (allocated as between spending for rehabilitation and spending

dressed to the same needs.[19] The Commission itself, in light of the railroads' revenue needs, has in a series of general revenue proceedings during the last

for other improvements in a manner quite similar to the USRA projections, i.e., about 30% (approximately $5.7 billion) for so-called catch-up maintenance and the 70% balance (approximately $13.1 billion) for other road expenditures). The remaining $15 billion First National City Bank projects as needed for acquisition of rolling stock and other equipment.

"The figures as to the amount of deferred maintenance in the nation's rail industry compiled by the Interstate Commerce Commission in its proceeding, *Ex Parte 305*, substantially comport with the $5.7 billion found by FNCB in its study.

"Moreover, the USRA in its analysis and discussion which accompanied the FSP also found deferred maintenance and delayed capital improvements to total $7.2 billion. This enormous figure reflects the insufficient earnings and inability to borrow prevalent in the rail industry.

"Because the capital needs of the Rail Industry appeared so enormous the Surface Transportation Subcommittee, in conjunction with the Transportation and Commerce Subcommittee of the House Committee on Interstate and Foreign Commerce, asked the Office of Technology Assessment (OTA) to provide an analysis of the nation's rail industry to supplement its evaluation of the United States Railway Association's Final System Plan. As part of that analysis by OTA, a study was conducted by Harbridge House, Inc. regarding the financial prospects of the rail industry and the industry's rehabilitation needs.

"In its report to the Office of Technology Assessment, Harbridge House evaluated the FNCB study described above. With the cooperation of FNCB, Harbridge House modified the FNCB projections in certain respects and determined that rail industry will experience a ten year cash shortfall of $5.0 billion.

"This cash shortfall which the nation's railroads face could increase by about $7 billion if, because of continuing financial weakness, the railroads lose their ability to finance equipment in the private sector."

[19] See, *e.g.*, Pub. L. 94–25, 89 Stat. 90, the "Amtrak Improvement Act of 1975" (May 26, 1975) (authorizing more than $1 billion to be spent over the next 27 months for operating and capital expenditures of the National Railroad Passenger Corporation).

seven years allowed the roalroads to increase their freight rates by approximately 60 percent. See J.S. App. 54a. These increases, granted without limits upon how the new revenues could be used, have not halted the deterioration of the railroads' plant and equipment.

Chessie, although a profitable railroad, shares the maintenance problems of other railroads. As the district court observed: "We have no doubt that Chessie's facilities require additional maintenance and improvement. For example, in 1973 it had 240 derailments because of defects and failures in its roadway as compared with 87 in 1964, an increase of 176 percent" (J.S. App. 15a). It is also beyond serious dispute that Chessie is replacing its ties and track at a rate requiring the ties to have a service life of 59 years before replacement (App. 67–69), whereas the industry standard, according to the ASTRO Report, is 35 years (App. 179). Chessie, like the other railroads, continues to fall behind in important repairs, maintenance and capital improvements.

In large measure the problems of the railroads have been caused by competition from alternative means of transportation, such as trucks, ships, barges, pipelines and aircraft. But the chronic maintenance problem also is attributable to the fact that under a system of rate regulation rates and quality of service are inextricably intertwined. A firm subject to maximum price regulation usually can increase its short-term profits by reducing its expenditures for maintenance. Because foregoing preventive maintenance and deferring making replacements usually does not produce an immedi-

ately observable deterioration in service quality, the firm can reduce its expenditures without reducing its revenues. Moreover, its competitors probably will follow the same strategy. In the long run, of course, this strategy is destructive, and a firm engaging in it would plan to make future investments in maintenance and improvements. But a firm subject to limitations upon the maximum prices it can charge, to severe competition from competing modes, and to declining demand for its services, may never be able to make up in the long run for savings taken in the short run.[21] Although the firm can improve its short term position by deferring maintenance and improvements, it cannot attract new capital to make up the deficit."

The Nation's railroads now appear to be in a position that feeds upon itself. In the short run it is advantageous to defer maintenance and improvements in order to increase the cash available for other purposes or for investors. In the long run individuals and institutions are unwilling to infuse new capital into railroads because the railroads cannot offer an attractive return. The railroads therefore may be unable to make up for past and present deferrals. This presents the Commission with two alternatives: (1) it could allow the circle to continue; or (2) it could allow the railroads to attempt to raise capital from their customers in the form of increased rates.

[21] See also H.R. Rep. No. 94–725, 94th Cong., 1st Sess. 73 (1975).

[22] When demand is increasing and competition is restricted the effect may be the opposite. See White, *Quality Variation When Prices are Regulated*, 3 Bell J. Econ. & Mgt. Sci. 425 (1972) (collecting sources).

The Commission decided to take the latter course, following the request of the railroads themselves. In *Ex Parte 305* the railroads requested an increase substantially larger than what was justified by cost increases. They asserted that the greater increase would be just and reasonable because it would enable them to devote the revenues to maintenance and capital improvements that they otherwise would be unable to afford. The Commission determined that, on the basis of additional costs alone, an increase of three percent was the maximum permissible increase (J.S. App. 42a–43a, 51a).

The railroads' request posed a practical problem for the Commission. Previous unconditional rate increases had not led to improved maintenance, and the Commission had no reason to believe that another unconditional increase in *Ex Parte 305* would have any greater effect. What is more, under traditional theories of ratemaking, the Commission's function is to ascertain whether the proposed rates are necessary to enable the railroads to earn a fair rate of return on their investment. The railroads were requesting here, in effect, that the Commission authorize rates higher than those that would be justified by that criterion. If the Commission had decided to allow the railroads to collect such rates without assurance that they would be devoted to the purpose that, the railroads asserted, made them just and reasonable, it arguably would have exceeded its powers under the Interstate Commerce

Act. Finally, the Commission recognized that it could not ensure that the revenues would be devoted to the purpose stated by the railroads unless it could impose pre-expenditure controls. The railroads' incentives to scrimp on maintenance would of course survive any revenue increase, no matter how large.

In theory the Commission could discipline a railroad that misled it about the uses to which it would put revenues collected only with the Commission's permission by reducing that line's rates and requiring it to make refunds. But because the railroads compete with each other (freight usually can be sent over two or more lines using different routes to reach the same destination), if the Commission ordered an offending railroad to reduce its rates other lines would be compelled to follow suit and would themselves be deprived of the funds they need to make improvements.

The Commission therefore concluded that in order to help the railroads alleviate their chronic maintenance deficiencies it would have to allow them to collect greater revenues, but that it would also have to make sure that the revenues were devoted to the purpose that made the increase just and reasonable. It allowed the railroads to increase their rates by seven percent over and above the three percent that ordinarily would have been justified. Chessie now claims that it must be allowed to enjoy the increased rates without complying with the conditions that alone make the rates just and reasonable. The district court agreed with Chessie.

The district court recognized that the conditions imposed by the Commission are justified if the Interstate Commerce Act authorizes them either explicitly or implicitly. We submit that the necessary implicit authorization for the Commission's actions is provided by Section 15a(2) of the Interstate Commerce Act when read, as it must be, in conjunction with the National Transportation Policy.

The Commission's decision whether to allow rates to become (or to remain) effective depends upon whether the rates are "just and reasonable." Section 15a(2) states that "[i]n the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration * * * to the need, in the public interest, of adequate and efficient railway transportation * * * and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management to provide such service." Section 15a(2) thus provides that the Commission is empowered to consider the relationship between service quality and price when setting rates. The Commission's decision to require the railroads to take steps calculated to improve the quality of their service, as a condition precedent to collecting increased rates, is a necessary concomitant to the Commission's powers under Sections 15a(2) and 15(7).

The power the Commission has asserted here:

> is intimately related to its power to set rates because a rate that would be reasonable for quality transportation service may well be unreasonable for inferior service;

is exercised only through the Commission's power over rates. The Commission has not attempted directly to control management's decisions;

does no more than direct the carriers to put the increased revenues to a use of the carriers' own choosing;

leaves to the carriers' management complete discretion concerning how it will expend the revenues within the broadest subject-matter constraints. Each railroad is free to set priorities, to select projects, and to determine how much will be spent upon each project and when it will be spent;

does not require any railroad to acquire or invest any of its own capital;

is not mandatory in nature. If any railroad desires to be free of the conditions the Commission believes are essential to make the increase just and reasonable, the railroad can avoid the conditions by declining to increase its rates.

Perhaps this case would stand in a different light if one or more of these factors were absent. But together they demonstrate how closely the conditions established by the Commission are related to its powers under Sections 15a(2) and 15(7).

If there is any uncertainty in this, it is dispelled by the National Transportation Policy, 54 Stat. 899, 49 U.S.C. preceding Section 1. The National Transportation Policy provides that "[a]ll of the provisions of [the Interstate Commerce Act] * * * shall be administered and enforced with a view to carrying out" the congressional declaration of policy. And Congress declared that it is the national transportation policy "to promote *safe, adequate,* economical and efficient service* * * —all to the end of developing, coordinating and *preserving* a national transportation system * * * adequate to meet the needs of commerce of the United States * * *" (emphasis added). If, as Chessie contends, only the carriers can determine whether and to what extent they will repair their facilities after the Commission has granted them a rate increase on the basis of their representations that the money was needed for such a purpose, then the Commission would be powerless to promote and preserve a safe and adequate transportation system. Under Chessie's construction of Section 15a(2), this part of the National Transportation Policy would be an exhortation by Congress that the Commission exceed its lawful powers. Since such a purpose should not be attributed to Congress, this Court should uphold the Commission's power to impose conditions in an attempt to achieve the goals set by the national transportation policy. As we discuss at pages 42–45, *infra,* the cases upon which the district court relied (all decided before the National Transportation Policy was enacted in 1940) are not to the contrary.

ARGUMENT

IN ORDER TO ENHANCE THE ADEQUACY AND EFFICIENCY OF THE NATION'S RAILWAY SYSTEM, THE COMMISSION HAS THE POWER TO REQUIRE THE CARRIERS TO USE REVENUES GENERATED BY A PERMISSIVE RATE INCREASE FOR THE PURPOSES THE CARRIERS INVOKED TO JUSTIFY THE INCREASE

In our view, the Interstate Commerce Act does not leave the Commission powerless to attempt to ensure

that railroads offer adequate service to the public. Under the Act, the Commission has the power to ensure that railroads, collecting increased rates only by the Commission's permission, will devote the revenues to the purposes for which, they say, they need the money. That is the only issue presented in this case, and it does not depend upon whether the restrictions on the use of revenues are reasonable, supported by evidence, or otherwise in accord with the standards governing the Commission's exercise of its discretion. The decision below is based solely upon a holding that the Commission is without authority to impose any restriction on the expenditure of funds derived from a rate increase. That narrow view of the Commission's powers is, we submit, incorrect.

A. THE NATURE AND HISTORY OF GENERAL REVENUE PROCEEDINGS INDICATE THAT THE COMMISSION IS ENTITLED TO INFLUENCE EXPENDITURES BY RAILROADS

At the heart of the district court's holding are, we believe, a number of misconceptions with respect to the nature and function of a general revenue proceeding. In order to illuminate these misconceptions, we begin with a brief discussion of the nature and history of the Commission's control over rates charged by regulated carriers.

The Transportation Act of 1920, 41 Stat. 456, created a scheme of regulation that was fundamentally different in nature, purpose and scope from the regulatory scheme embodied in earlier Interstate Commerce Act provisions. The Interstate Commerce Act originally had been designed primarily to protect

shippers against unreasonably high or discriminatory rates. It established machinery for posting, publishing and filing tariffs and established a single forum to enforce the railroad's common law obligations as a common carrier with respect to shippers in interstate commerce. See 24 Stat. 379. The Commission's powers to protect shippers were subsequently reinforced by giving the Commission the power to prescribe rates and the power to suspend rate changes for a limited period to permit the Commission to determine whether a proposed new rate would be just and reasonable.[22] These regulatory provisions did not, however, give the Commission any broad powers or responsibilities with respect to the financial health or practices of the railroads. So long as the railroads refrained from charging excessive or discriminatory rates or subjecting shippers to other unreasonable practices, their business affairs were unregulated by the Commission.

The First World War precipitated a fundamental change in the relationship between the federal government and the railroads. The government assumed direct control of the railroads during that war. After the war ended Congress concluded that the federal government should retain a considerable degree of control over the management of the railway system and that these powers and responsibilities should be vested in the Interstate Commerce Commission.

This increase of federal regulation was thought to be necessary because of serious deficiencies in the

[22] See generally *Arrow Transportation Co.* v. *Southern Ry.*, 372 U.S. 658, which describes many of these amendments.

railway system that, Congress believed, were likely to recur if all of the pre-war prerogatives were restored to the railroad owners and the state regulators. See 1 Sharfman, *The Interstate Commerce Commission* 94–103, 177–182 (1931).

The Transportation Act of 1920 gave the Commission a new set of powers that became effective when the railroads were returned to their owners. That Act authorized railroads to enter into pooling agreements with the approval of the Commission (49 U.S.C. 5), directed the Commission to formulate consolidation plans for the industry (*ibid.*), prohibited the opening of new lines or the abandonment of old ones without Commission approval (49 U.S.C. 1(18) and 1(20)), required the railroads to obtain Commission approval for securities offerings (49 U.S.C. 20a and 20b), gave the Commission the power to adjust the division of revenues from joint rates (49 U.S.C. 6), authorized the Commission to compel railroads to extend their lines and make connections (49 U.S.C. 1(21)), and expanded the Commission's power to compel changes in intrastate rates (49 U.S.C. 15 and 15a).

One of the major new rate provisions of the 1920 Act was Section 15a. Section 15a(2) then provided (41 Stat. 488):

> In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation: *Provided,* That the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different sections of the country.

Since a rate level that established a "fair return" for the "carriers as a whole" would yield an excessive return for some carriers and an inadequate return for others, the 1920 Act also created a mechanism for redistributing revenues among railroads. The "recapture clause" of Section 15a required railroads receiving revenues in excess of the "fair return" determined by the Commission to contribute a portion of the excess to a fund, which the Commission could use to loan money to less fortunate railroads to improve their facilities.

In *Railroad Commission of Wisconsin* v. *Chicago, Burlington & Quincy R.R.*, 257 U.S. 563, 585, this Court described the Transportation Act of 1920 as a "new departure" that "imposed an affirmative duty on the Interstate Commerce Commission to fix rates and to take other important steps to maintain an adequate railway service for the people of the United States." The Court concluded that those other steps included the power to increase intrastate rates for the

purpose of assuring that intrastate commerce makes an adequate contribution to the revenues needed to maintain an adequate national railway system.

In the *New England Divisions Case,* 261 U.S. 184, this Court concluded that the "other steps" also included changing the division of rates among railroads for the sole purpose of providing less affluent railroads with revenues necessary to improve their facilities. In reaching that conclusion the Court described the history and purposes of the 1920 Act as follows (*id.* at 189–190, footnotes omitted):

> Transportation Act, 1920, introduced into the federal legislation a new railroad policy. *Railroad Commission of Wisconsin* v. *Chicago, Burlington & Quincy R.R. Co.*, 257 U.S. 563, 585. Theretofore, the effort of Congress had been directed mainly to the prevention of abuses, particularly, those arising from excessive or discriminatory rates. The 1920 Act sought to ensure, also, adequate transportation service. That such was its purpose, Congress did not leave to inference. The new purpose was expressed in unequivocal language. And to attain it, new rights, new obligations, new machinery, were created. The new provisions took a wide range. Prominent among them are those specially designed to secure a fair return on capital devoted to the transportation service. Upon the Commission, new powers were conferred and new duties were imposed.
>
> The credit of the carriers, as a whole, had been seriously impaired. To preserve for the nation substantially the whole transportation system was deemed important. By many railroads funds were needed, not only for improvements and expansion of facilities, but for adequate maintenance. On some, continued operation would be impossible, unless additional revenues were procured.

The Court described the basic purposes of the 1920 Act again in *Dayton-Goose Creek Ry.* v. *United States,* 263 U.S. 456, 478. The Court said: "The new act seeks affirmatively to build up a system of railways prepared to handle promptly all the interstate traffic of the country. It aims to give the owners of the railways an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden."

The general revenue proceeding authorized by Section 15a(2) necessarily became one of the central features of the new regulatory scheme. Although the Commission had sometimes considered the reasonableness of rates and rate changes collectively,[24] the 1920 Act changed the nature of such proceedings. Commission consideration of rates in general was no longer merely a convenient way for the Commission to discharge its obligation to determine whether carrier-initiated rate changes are just and reasonable, but also served as a means of fulfilling the Commission's obligation under Section 15a to determine whether the overall rate level in the nation or a particular region is in line with the aggregate revenue needs of the rail-

[24] See the *New England Divisions Case*, *supra*, 261 U.S. at 197–198, for a description of earlier general rate proceedings.

roads. A general rate proceeding became a general revenue proceeding.[25]

The 1920 Act did not, of course, give the Commission power to make all decisions in management's stead or to issue orders directing management to invest capital in particular ways. See *Interstate Commerce Commission* v. *United States ex rel. Los Angeles*, 280 U.S. 52. But, through the general revenue proceeding and Section 15a, it gave the Commission substantial *indirect* power to influence the decisions of management, when those decisions would affect the safety and adequacy of the railway system. The 1920 Act provided the Commission with the tools it needed to combat "the developing inadequacy of transportation plant and equipment" (Sharfman, *supra,* at 95).

Section 15a(2) assumed its current form in 1933. The Emergency Railroad Transportation Act of 1933, 48 Stat. 211, 220, repealed the recapture clause, directed the Commission to return remaining funds to the contributing railroads, and revised the rule of ratemaking.[26] The revised language omitted all references to a fair rate of return and substituted the

[25] See *United States* v. *Louisiana*, 290 U.S. 70, for a description of a general revenue proceeding conducted prior to the 1933 revision of Section 15a(2) (48 Stat. 220) and a discussion of the relationship between that procedure and the rule of ratemaking established in Section 15a(2).

[26] Subsequent amendments to Section 15a have not affected the substance of Section 15a(2). The Act of August 9, 1935, 49 Stat. 543, made formal changes. The Act of September 18, 1940, 54 Stat. 912, inserted the words "by the carrier or carriers for which the rates are prescribed." The Act of August 12, 1958, 72 Stat. 572, added Section 15a(3). And the Act of July 10, 1973, 87 Stat. 166, added 49 U.S.C. (Supp. III) 15a(4).

present language, which requires the Commission to give consideration to "the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management to provide such service."

The reasons for the changes are described in the report of the House Committee on Interstate and Foreign Commerce, H.R. Rep. No. 193, 73d Cong., 1st Sess. 28-30 (1933). The Committee observed that continuation of the recapture procedure would serve no useful purpose since none of the railroads have any excess revenues to recapture, and that past contributions should be returned to enable the contributing railroads to meet urgent cash needs. The Committee apparently concluded that it would also be futile to require the Commission to attempt to set rates that would provide a "fair return" to shareholders under depression conditions; it therefore stated new factors for the Commission to consider—factors that afforded the Commission even greater flexibility than it had possessed under the 1920 version of Section 15a(2).

This Court examined the effects of the 1933 amendment upon the Commission's functions in *Florida* v. *United States,* 292 U.S. 1. The Commission had issued a pre-amendment order requiring an increase in the intrastate rate for logs. The Commission had concluded that the intrastate shipments did not make a sufficient contribution to revenue, but had not found

that there was any discrimination against particular shippers or localities. Florida claimed that the Commission could no longer prescribe intrastate rates for revenue purposes because prior orders of this type had been sustained on the theory that they "supplemented" the Commission's Section 15a powers. Florida contended, in effect, that by repealing the recapture clause Congress had abandoned its effort to use rate regulation as a means of curing deficiencies in the railway system. This Court rejected that claim. It noted that the new language requires the Commission to consider "'the effect of rates on the movement of traffic'," "'the need * * * of adequate an efficient railway transportation service'" and "'the need of revenues sufficient to enable the carriers * * * to provide such service," and concluded that the amendment of Section 15a did not eliminate the Commission's power and responsibility to assure that intrastate commerce makes a sufficient contribution to an adequate railway system. *Florida* v. *United States, supra,* 292 U.S. at 7–8.

Florida v. *United States* supports our contention that the Commission has a continuing power and duty to utilize its rate regulation powers to promote a more adequate railway system. In particular, the Commission has the implicit power to impose conditions in an order authorizing a general rate increase, when those conditions are related to the adequacy and efficiency of the railway transportation system, are general in nature, and respond to needs identified by the railroads themselves.

If there were any doubt about the Commission's authority to use its ratemaking and suspension powers in this fashion, the doubt should have been dispelled by the National Transportation Policy, the preamble to the Act of September 18, 1940, 54 Stat. 899, 49 U.S.C. preceding Section 1. The National Transportation Policy declares that it is the "policy of the Congress" to provide for regulation designed "to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; * * *—all to the end of developing, coordinating, and preserving a national transportation system * * * adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense." The Policy concludes: "All of the provisions of [the Interstate Commerce Act] * * * shall be administered and enforced with a view to carrying out the above declaration of policy."

The Court has "made it clear that [the national transportation] policy is the yardstick by which the correctness of the Commission's actions will be measured." *Schaffer Transportation Co.* v. *United States,* 355 U.S. 83, 88. The Commission has used its ratemaking and suspension powers in this case in order to achieve the goals established by the National Transportation Policy, and, accordingly, this Court should uphold the conditions the Commission has imposed—conditions that render the increase just and reasonable in light of the unquestionable need to improve the railroads' deteriorating plant and equipment.

B. THE CONDITIONS ESTABLISHED BY THE COMMISSION ARE INTIMATELY RELATED TO RATEMAKING AND ARE IMPLICITLY AUTHORIZED BY THE COMMISSION'S POWER TO DISAPPROVE UNJUST AND UNREASONABLE RATES

We think it fair to say that the power to establish conditions precedent to the authorization of a rate increase is implicit in the power of the Commission to deny (or defer) a rate increase altogether, and the concomitant power of the Commission (established by Section 15a(2) and the National Transportation Policy) to consider adequacy of the service rendered as a factor in its decision whether rates are just and reasonable.[27]

We do not mean by this that the Commission has the power to impose *any* condition, no matter how intrusive upon the ordinary prerogatives of management and no matter how unrelated to whether the rates are just and reasonable. The Commission's authority in this regard is limited by a requirement that

[27] If enacted into law, Section 205 of the Railroad Revitalization and Reform Act of 1975 would make even clearer the authority of the Commission to consider the maintenance needs of the railroads when establishing rates. Section 205 would make the present Section 15a(2) inapplicable to railroads and would add a new section, 49 U.S.C. 15a(4), which would provide:

"With respect to common carriers by railroad, the Commission shall, within 24 months after the date of enactment of this paragraph, after notice and an opportunity for a hearing, develop and promulgate (and thereafter revise to the extent appropriate and maintain) reasonable standards and procedures for the establishment of revenue levels adequate under honest, economical, and efficient management to cover total operating expenses, including depreciation and obsolescence, plus a fair, reasonable, and economic profit and/or return on capital employed in the business, which revenue levels should provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure

the conditions be related to the reasonableness of the rates in issue. There may be other limitations as well. We need not explore that possibility here, for conditions of the sort involved in this case are within the bounds of the Commission's power, whatever those bounds may be.

The railroads themselves have acknowledged that the conditions established by the Commission are intimately related to its power to suspend proposed changes in rates. The railroads sought to increase rates to an extent that was not justified by recent increases in operating costs. The railroads argued that the additional increase was justified by their need for funds with which to perform deferred maintenance and make delayed improvements to track and other facilities. The Commission has done no more than to ensure that the railroads will put the new revenues to the purposes that they asserted would justify allowing them to collect those revenues. In short, the conditions simply hold the railroads to their own representations in order to make sure that the rates collected are just and reasonable in relation to the service rendered.

the repayment of a reasonable level of debt, permit the raising of needed equity capital, and cover the effects of inflation. Such revenue levels should insure retention and attraction of capital in amounts adequate to provide a sound transportation system in the United States. The Commission shall make an adequate and continuing effort to assist such carriers in attaining such revenue levels."

This section, however, like the current Section 15a(2), provides no explicit answer to the question whether the Commission can impose conditions in order to ensure that the revenues are used for the purpose that makes their collection just and reasonable.

The intimate relationship between the Commission's conditions and its ratemaking powers is confirmed by the manner through which the expenditure controls came into being and are enforced. The Commission did not enter an *ex cathedra* order directing the railroads to invest entrepreneurial capital in a particular way. It did no more than set forth conditions for the nonsuspension of rates—conditions that the Commission deemed necessary to the reasonableness of rates proposed by the carriers. The carriers were not called upon to attract or invest any of their own capital; the conditions pertain only to the expenditure of additional funds they will collect from shippers. The carriers were not compelled to undertake any maintenance or improvements; they were required to do so if and only if they increased their rates by more than the three percent that was justified by increases in costs. And the carriers were required to devote to maintenance and improvements only the sums so collected.

Not only were the carriers free to decline to increase their rates—and thereby to avoid any controls upon their expenditures—but also they were at liberty to object to the Commission's invitation to file new tariffs subject to restrictions upon use of the revenues derived from the increases.[28] If the railroads had declined to refile, the Commission probably would have suspended their proposed tariffs. Since, under Section 15(7), the

[28] Chessie was not required to join the other railroads in the cancellation and refiling. It could have exercised its right (see 49 U.S.C. 5b(6)) to file independently. See *Ajayem Lumber Corp.* v. *Penn Central Transportation Co.*, 487 F. 2d 179 (C.A. 2).

maximum period of suspension is seven months, the carriers would have been free thereafter to increase their rates without regard to the Commission's views concerning how the revenues should be used.[29]

Finally, the Commission left to the carriers' management full discretion over how the revenues would be spent, within very broad outlines (J.S. App. 81a). Each railroad remains free to establish priorities among types of maintenance and improvements, and to devote the revenues from *Ex Parte 305* to projects of its own choosing. The Commission exercises no control over particular projects or expenditures. And because even this broad subject-matter control may, on occasion, be unduly restrictive, the Commission has provided that any carrier may apply to use *Ex Parte 305* revenues for purposes other than deferred maintenance or delayed capital improvements. It has been liberal in granting such requests. See J.S. App. 107a–108a.

In sum, the Commission has not attempted here to exercise an unfettered power over management decisions. It has attempted to fulfill the goals set out by Congress in the National Transportation Policy. Its control over expenditures is exercised indirectly,

[29] The Commission then would have initiated a full investigation into the propriety of the rates proposed by the railroads and would have had the authority to declare the proposed rates unjust and unreasonable in the absence of guarantees that the carriers would devote the revenues to the purposes that the carriers asserted justify the increase. In that event, however, the Commission would have held full hearings at which the carriers could have objected to any proposed use restrictions.

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through its power over rates, to achieve improvements in the service rendered in exchange for the rates charged. The Commission has not asserted a broad power over management decisions; the decision regarding why and for what purpose additional funds are required was made by the railroads themselves. It has simply held the railroads to their word.

To the best of our knowledge, the only federal case to consider similar action under a similar statute is *D.C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission,* 466 F. 2d 394 (C.A.D.C.), certiorari denied, 409 U.S. 1086.[30] The statute involved there allowed the Transit Commission to set rates based in part upon "the need, in the public interest, of adequate and efficient transportation service" (see 466 F. 2d at 408, n. 98)—a standard functionally identical to that of Section 15a(2). The Transit Commission declined even to consider D.C. Transit's request for a fare increase until D.C. Transit had borrowed substantial sums and invested them to improve its service. The court of appeals sustained the Transit Commission's order, stating that the carrier "is not entitled * * * to a fare raise irrespective of the quality of its operation and service" (*id.* at 409). And, the court went on (*id.* at 411): "Nor is there room for doubting the validity of an order which gives * * * direction [to improve service] concurrently with a grant of a fare increase * * *." See also *United Telephone Co. of Florida* v. *Mayo,* 215 So. 2d 609 (Fla. Sup. Ct.), appeal dismissed, 394

[30] Cf. *In re North American Light & Power Co.,* 170 F. 2d 924 (C.A. 3).

U.S. 995; *State ex rel. Puget Sound Navigation Co.* v. *Department of Transportation,* 33 Wash. 2d 448, 482, 206 P. 2d 456, 475 (an agency's power to suspend rates "necessarily implies the power to allow the tariff to become immediately effective, pursuant to reasonable conditions or limitations"). Other cases to a similar effect are collected in *D.C. Transit, supra,* 466 F. 2d at 408, n. 101; at 409, n. 102; at 411, n. 119.

In *D.C. Transit* the Transit Commission simply denied the rate increase altogether until the carrier had complied with certain conditions. But this power is one more sweeping, and more intrusive upon management's prerogatives, than is the action of the Commission here. In *D.C. Transit* the carrier was required to raise and invest private capital as a precondition to increasing its fares; here the carriers have been allowed to increase their rates first and use the revenue so generated to improve their service.[31] *D.C. Transit* and the state cases upon which it relies thus provide strong support for the Commission's action here.

[31] See Note, *The Duty of a Public Utility to Render Adequate Service: Its Scope and Enforcement,* 62 Colum. L. Rev. 312, 330–331 (1962): "When a utility's financial condition is such that an improvement in service is extremely difficult to achieve under the existing rate structure, to deny a rate increase until service improvements have been made is self-defeating, and rate increases clearly must precede improvement. But there appears to be no reasonable objection to conditioning a presently granted rate increase on future service improvements * * *. * * * Although perhaps this does some violence to the traditional notion that rates should be set solely on the basis of a fair rate of return, it must be recognized that a utility providing inadequate service is breaching a duty to the public and should not be able to secure a rate increase before it has fulfilled its obligation."

As we next discuss, neither the decisions of this Court nor previous decisions of the Commission detract from the force of this analysis.

C. THE CASES RELIED UPON BY THE DISTRICT COURT DO NOT SUPPORT ITS CONCLUSION

The district court discussed several cases that, it thought, established a rule "that the Commission has no general power to control a railroad's expenditures" (J.S. App. 21a).

The first of these cases is *United States* v. *Pennsylvania R.R.*, 242 U.S. 208. The Commission had ordered a railroad to furnish tank cars in sufficient numbers, as part of its service as a common carrier. The Court held that, whether or not railroads had such a duty under the common law, Congress had not authorized the Commission to implement it. This case does not support the district court's decision: it does not involve the Commission's rate or suspension powers. What is more, Congress, evidently dissatisfied with that decision, promptly provided in express terms the powers the Court found wanting.[32]

The second case is *Interstate Commerce Commission* v. *United States ex rel. Los Angeles, supra.* The City of Los Angeles, desiring all of the railroads serving it to share a common treminal, sought to require the Commission to compel the railroads to construct and use such a terminal. The Commission declined, correctly as the Court held. The Court concluded that

[32] See 49 U.S.C. 1(10) to 1(22), added by the Transportation Act of 1920.

the power to compel carriers to construct and use specified facilities could be conferred on the Commission only by express statutory provisions. That case, like *Pennsylvania R.R.*, is far removed from ratemaking. It involved direct control over capital investment—"requisitioning investment of capital of the carriers" (280 U.S. at 70)—rather than indirect control designed to ensure the reasonableness of rates. The Court relied upon this point, observing that in the case before it "the expenditure of a large amount of capital will not bring with it [a] corresponding increase in the railroad revenues" (*ibid.*).

The only other decision relied upon below is *Missouri Pacific R.R.* v. *Norwood*, 42 F. 2d 765 (W.D. Ark.), affirmed, 283 U.S. 249. Missouri Pacific asserted that a state full-crew law was unconstitutional under the Commerce Clause. This Court upheld the law, reasoning that Congress had not so occupied the field that a State was prohibited from setting crew sizes with a view to ensuring safe operations. On its face, *Norwood* has nothing to do with the question presented here.

The district court, however, seized upon language in the district court's opinion in *Norwood*. Missouri Pacific had argued below that state full-crew laws were preempted because the Commission had been given the power to regulate crew size. The district court disagreed, observing that, under the "recapture clause" of Section 15a, the Commission could exercise control over crew size "only through the rate of return allowed * * *. * * * There is no suggestion in the sec-

tion as enacted, in the committee reports or in the congressional debates of any direct control by the Commission of any expenditures of the carriers * * *" (42 F. 2d at 773). If this language were controlling, it would support the Commission's action here, for the Commission has acted indirectly, through its control over rates.

However that may be, we think that this Court's opinion is more instructive. Responding to Missouri Pacific's contention that the employee practices covered by the full-crew law were "practices" within the control of the Commission under various sections of the Act, including Section 15a, this Court wrote (283 U.S. at 257):

> The Act uses the word "practice" in connection with the fixing of rates to be charged and prescribing of service to be rendered by the carriers, but these matters differ widely in kind from the subject covered by the Arkansas laws. That word is deemed to apply only to acts or things belonging to the same class as those meant by the words of the law that are associated with it. *Baltimore and O.R. Co.* v. *United States*, 277 U.S. 291, 300.

This language is inconsistent with the district court's pronouncement that Section 15a "provides control only through the rate of return." More important, it establishes that the word "practice," which appears in Section 15a(1) and is embraced within the term "rates" as used in Section 15a(2), includes not only the "fixing of rates to be charged" but also the "prescribing of service to be rendered by the carriers"

(283 U.S. at 257. That is all the Commission has done here.

Further, as we have pointed out at page 32–36, *supra,* Section 15a was amended after *Pennsylvania R.R., Los Angeles,* and *Norwood* were decided. The "recapture clause" has been repealed and the new language of Section 15a(2) substantially expands the Commission's powers. We submit, therefore, that those cases in no way detract from our argument.

The district court also relied (J.S. App. 18a–19a) upon prior decisions by the Commission itself. In these decisions, the court asserted, the Commission disavowed possession of the power it now has exercised. This is inaccurate. The Commission's prior decisions involved the question whether it has the power, divorced from rate proceedings, to compel carriers to undertake specific acts or make specific investments of their own capital. For example, in *Missouri-Kansas-Texas R.R.* v. *Kansas City Terminal Ry.,* 104 I.C.C. 203, quoted extensively by the court below (J.S. App. 19a), the Commission disavowed any power to restrain a carrier from spending revenues on an allegedly improvident rail operating agreement between the Kansas City Terminal Railway and various other railroads. Here by contrast, there was no effort whatever to instruct the railroads to spend their revenues on any specific project of any description. The Commission's prior cases are immaterial here for the same reasons that *Pennsylvania R.R., Los Angeles,* and *Norwood* are not controlling.

In any event, even if the Commission's prior decisions could be interpreted as disavowing the type of

power now asserted, the Commission is entitled to revise its interpretation of the Act in response to developing conditions in the transportation industry. This Court repeatedly has emphasized that every administrative agency has not only the authority but also the obligation to review its mandate and, where necessary, to reach new conclusions. *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 170–171; *American Trucking Associations* v. *Atchison, Topeka & Santa Fe Ry.*, 387 U.S. 397; *Federal Trade Commission* v. *Dean Foods, Inc.*, 384 U.S. 597, 608–611; *Securities & Exchange Commission* v. *Chenery*, 332 U.S. 194, 202. As the Court wrote in *American Trucking, supra*, 387 U.S. at 416:

> [T]he Commission, faced with new developments or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice. Compare *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947); *FCC* v. *WOKO*, 329 U.S. 223 (1946). In fact, * * * this kind of flexibility and adaptability to changing needs and patterns of transportation is an essential part of the office of a regulatory agency. Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy. They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.

The Commission has delineated the circumstances that called for it to assert the power to impose the

expenditure restrictions. It expressed concern over the "inadequacy of the services provided shippers by the respondent railroads," notwithstanding that "during the time rail service deteriorated, rail rates have had to be increased as a result of inflation to cover increased wage, fuel material, and interest costs as well as rising payroll taxes" (J.S. App. 47a). The Commission referred to the undeniable "low level of earnings by the railroad industry which has contributed to the deferral of maintenance of plant and equipment, the postponement of capital improvements, and the depletion of the industry's net working capital" and went on (*ibid.*): "These factors in combination have caused a serious deterioration of rail service and increased expenses due to slow orders, car shortages, derailments, and shortages of locomotives."

It was against this background that the Commission concluded (J.S. App. 47a–48a):

> Our responsibilities under the Act, *inter alia*, section 15a(2), require that we give consideration to "the need, in the public interest, of adequate and efficient railway transportation *service* at the lowest cost consistent with the furnishing of such *service;* and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management to provide such *service.*" [Emphasis supplied by the Commission.]

The Commission also stated that the increased revenue "will enable the [carriers] to expend substantially more for maintenance and capital improvements than in recent years" (J.S. App. 48a). This was a sufficient

expression of the Commission's view (and review, if one was needed) of its mandate under the Act.

The Commission could have blocked all increases exceeding three percent by using its Section 15(7) suspension power, explaining that it was doing so because there was no assurance the railroads would spend the additional funds for the only purpose that would justify the increased rates. The Commission was entitled to take a less intrusive course. The railroads, including Chessie, said they needed higher rates and more money for deferred maintenance and capital improvements. The Commission found that higher rates would be just and reasonable only if the additional money were devoted to such ends. The Commission therefore properly allowed the increases to go into effect on condition that the money generated be used for deferred maintenance and capital improvements. It is difficult to perceive why all this is an abuse of power by the Commission and, we believe, it is not.

Chessie's argument to the contrary embodies the proposition that after convincing the Commission to allow the increased rates only because of the railroads' need for money to maintain and improve their facilities, Chessie should be free to spend the fruits of its success in the general revenue proceeding for whatever purpose it sees fit. But under the Interstate Commerce Act the carriers' representations in such proceedings are not to be made solely for the purpose of persuasion and then ignored after achieving their intended result. When the Commission accepted the

railroads'—and the Chessie's—justifications for the higher rates, it had the power to treat those arguments as promises by conditioning the rate increase on the railroads' doing what they said they would.

CONCLUSION

The decision of the district court should be reversed and the case remanded for further proceedings.

Respectfully submitted.

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